

Service Date: November 2, 1998

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Investigation of)	UTILITY DIVISION
the Sale and Transfer of PacifiCorp's Distribution)	
System and Public Utility Obligations to)	DOCKET NO. D98.10.218
Flathead Electric Cooperative, Inc.)	ORDER NO. 6103a

ORDER APPROVING PROPOSED SALE
OF PACIFICORP'S ELECTRIC DISTRIBUTION SYSTEM
TO FLATHEAD ELECTRIC COOPERATIVE, INC.

Introduction

The Montana Public Service Commission (PSC or Commission) issues this Order approving the sale of PacifiCorp's distribution facilities to Flathead Electric Cooperative, Inc. (Flathead), subject to terms and conditions of the sale and transfer of the facilities and public utility obligations to Flathead as set forth in this Order. This Order also serves as the Commission's final approval of the Settlement Agreement entered into by the Commission, PacifiCorp, the Montana Consumer Counsel (MCC) and Flathead, in resolution of the litigation in Cause No. DV-98-437B, Flathead County, Eleventh Judicial District Court. As a result of this Order and approval of the negotiated Settlement Agreement, the court may dissolve the temporary restraining order on November 2, 1998 and dismiss the request for injunctive relief, with prejudice.

Procedural Background

1. PacifiCorp, a public utility providing electric service to 36,000 customers in Montana, primarily in Flathead and Lincoln counties, announced in September, 1998 its intention to sell its electric distribution facilities (with a small amount of transmission) without Commission oversight or approval. PacifiCorp maintained that it would be entitled to any gain on the sale. The proposed sale would not include sale of its generation facilities.

2. PacifiCorp is involved in a proceeding before the Commission on its plan for transition to customer choice of electricity supply (production or generation), Docket No. D97.7.91, filed pursuant to Senate Bill 390 (Title 69, Chapter 8, Montana Code Annotated (MCA)). The

Commission conducted hearings in this Docket in May and September, 1998, and may issue its final Order in Docket No. D97.7.91 on PacifiCorp's transition plan before the end of the year on whether to approve, modify or deny the transition plan.

3. The Commission and the MCC, co-Plaintiffs, brought an action for injunctive relief in the Eleventh Judicial District Court, Cause No. DV-98-437B, to prevent PacifiCorp, Defendant, from selling and transferring its distribution system facilities and public utility obligations in Montana, until the Commission conducted proper procedures to evaluate and approve the sale. Flathead's Motion to Intervene in Cause No. DV-98-437B was granted, limited to representation of the proposed purchaser's interests. The four parties finalized a Settlement Agreement on October 8, 1998, to stay the preliminary injunction proceeding pending the Commission's investigation of the sale and determination by October 30, 1998 of whether the proposed transaction is in the public interest. PacifiCorp agreed to remain in the transition cost proceeding in Docket No. D97.7.91, without any of the parties waiving jurisdictional arguments.

4. The Commission established Docket No. D98.10.218 to investigate whether the proposed sale and transfer of PacifiCorp's distribution system and public utility obligations to Flathead is in the public interest. This investigation is a separate proceeding apart from the "Electrical Restructuring Transition Plan Proceeding" in Docket No. D97.7.91. The Commission suspended the Procedural Schedule and vacated the hearing on the distribution system sale scheduled for November 30, 1998 in Docket No. D97.7.91, pending the Commission's investigation and decision on the sale.

5. On October 13, 1998, the Commission issued Protective Order, Order No. 6103, to facilitate third party participation. PacifiCorp and Flathead Electric provided documents and information on the sale transaction for viewing at the Commission's and the Montana Consumer Counsel offices. PacifiCorp also made its documents available for viewing at the offices of Dana Christensen, Christensen, Moore, Cockrell & Cummings, P.C., Two Medicine Building, 160 Heritage Way, Kalispell, Montana (local counsel).

6. On notice of intention to participate in the Commission's proceeding in this Docket and signing an Exhibit A to Order No. 6103, James A. Robischon, Kalispell, obtained access to a set of these documents. Likewise, representatives of the Department of Environmental Quality (DEQ), also Intervenor in Docket No. D97.7.91, intervened and participated in the Docket.

7. On October 19, 1998, the Commission conducted two noticed meetings for the benefit of the public in PacifiCorp's service territory at 12:00 p.m., Libby City Hall, Ponderosa Room, 952 East Spruce Street, Libby, Montana, and at 7:15 p.m., Courthouse East, Conference Room #1 (Old Chapel), 723 5th Avenue East, Kalispell, Montana. The public had the opportunity to submit written and oral testimony and comments at these meetings, following the presentations of PacifiCorp and Flathead on the proposed transaction, or later in this Docket. Customers also contacted the Commission directly.

8. On October 26, 1998, the Commission conducted a public meeting in the Bollinger Hearing Room, 1701 Prospect Avenue, Helena, Montana, beginning at 1:30 p.m., for the benefit of those Intervening Parties in Docket No. D97.7.91 with an interest in the distribution system sale and a position on whether the proposed transaction is in the public interest.

9. On October 28, 1998, the Montana Consumer Counsel, as required by the Settlement Agreement, presented his recommendation to the Commission on whether the Commission should render final approval of the Settlement Agreement on the proposed transaction, for purposes of dismissing the lawsuit. Mr. Robischon submitted his recommendation on the sale in his Statement filed October 28, 1998. Larry Nordell submitted the recommendation of the DEQ on the same date.

10. On October 29, 1998, Energy Northwest, Inc. (ENI), Flathead's affiliate to provide service in the non-rural electric service territory, applied for authority to adopt and implement PacifiCorp's electric service tariffs as the tariffs for ENI's operation of the distribution system, if the sale were approved.

11. On October 30, 1998, the Commission concluded its investigation and proceedings and decided to accept the Settlement Agreement with the negotiated Net Gain of \$4 million to be allocated to PacifiCorp's ratepayers. The Commission granted MCC's recommendation for allocation of this gain, \$1.25 million to distribution system improvements in PacifiCorp's existing urban territory and \$2.75 million to PacifiCorp's residential and small commercial customers. This Order will be submitted to the Court on November 2, 1998 as final settlement of the litigation in Cause No. DV-98-437B, for the purposes of dissolving the temporary restraining order and dismissing the injunction proceeding.

Summary of Public Meetings

12. PacifiCorp and Flathead made presentations at the public meetings in Kalispell and Libby and again before the Commission on the sale. PacifiCorp wanted to sell as quickly as possible to alleviate uncertainties and to move on with its business plans. Flathead wanted to purchase as quickly as possible and move on with the integration of their two, often contiguous systems, to provide service in northwestern Montana.

13. Flathead represented the following. Flathead operates a rural electric cooperative providing service to 12,000 customers, primarily in Flathead and Lincoln counties. The benefits derived from the Flathead purchase of PacifiCorp's system include integration of the two systems in a way that will improve reliability of the system without any negative impacts. Flathead stated that there would be no rate increases in the transition period. Although not distinguishing between rates versus bills and between delivery-related versus supply-related rate components, Flathead was clear on its position that Senate Bill 390 capped rates and that Flathead intended to reduce rates. Flathead will adopt PacifiCorp's existing rates for the PacifiCorp's rural and urban customers. Flathead intends to do a cost of service rate study and develop uniform rates for all its customers.

14. Flathead will continue to be a member-owned and –controlled cooperative, with a Board elected by the membership. Rural customers currently served by PacifiCorp will become members of Flathead, which will provide transmission, distribution and power supply. Eventually, Flathead's members will all have the opportunity to choose their power supplier when Flathead implements its transition plan. The urban customers in the areas of Whitefish, Kalispell and Columbia Falls over the 3,500 population threshold, and therefore not qualifying as rural electric cooperative customers, will be served by Energy Northwest, Incorporated (ENI). ENI will have its own board, and also will be a member of Flathead. Although legally a for-profit enterprise, ENI will be operated as a cooperative under non-profit principles for the benefit of its customers. It will provide the distribution facilities for its customers, will purchase power supply from Flathead to resell to its customers, and will contract with Flathead to provide customer services. ENI will be regulated by the Commission, according to Flathead's representations.

15. Flathead stated that its sources of power supply include its firm load requirement from a contract with PacifiCorp and load following from another entity, possibly Bonneville Power Association.

16. Flathead/ENI indicated that it would file with the Commission a modified transition plan which would propose customer choice for electricity supply starting July 1, 2000, delaying for one year both PacifiCorp's and Flathead's transition plan implementation.

17. In addressing specific concerns raised by customers, Flathead promised the following. For those customers with Simple Choice – Flathead will honor existing appliance maintenance contracts through their duration. On the question of the charges for CATV pole attachments – FEC will honor existing contracts for the duration of the contractual agreements. The Code of Federal Regulations addresses guidelines for charging for pole attachments and complaint procedures. On termination of service (Flathead's termination fee is high) – Flathead will apply PacifiCorp's current termination policies until such time as a new board is established and addresses a comprehensive termination policy for the entire service territory. Flathead's affiliate, ENI, will not terminate service to a customer for non-payment of any Flathead bill and would be willing to set this forth in a written policy. Flathead would be willing to inform ENI customers of their right to file complaints with the PSC. Flathead will assume existing contracts of PacifiCorp, including pole attachment contracts. Flathead needs skilled employees, and is successfully negotiating to hire PacifiCorp's highly qualified local employees.

18. In addressing the concerns of local government on loss of property taxes, Flathead committed that it would provide equivalent payments in lieu of taxes to those made by PacifiCorp as a privately owned public utility.

19. On the treatment of gain on the sale, Flathead proposed using PacifiCorp's customers' portion of net gain to replace and improve distribution facilities to address reliability issues in PacifiCorp's municipal service territory to be under ENI. In some cases, these improvements could involve connecting radial lines in the PacifiCorp service area to Flathead facilities, which might also create reliability benefits for existing Flathead customers. Flathead represented that the expenditures for these facility enhancements would be made in any case and the facility enhancements would be used and useful for the benefit of customers. Flathead represented that

these expenditures will appear “below the line” and will not be reflected in rates, as would be the case otherwise.

Summary of Statements and Public Comment

20. MONTANA CONSUMER COUNSEL. MCC generally believes that that there may be positive outcomes from the proposed sale such as local control, efficiencies from combined systems and favorable financing arrangements. MCC stated that, while limited by constraints inherent in this expedited process, its review of the proposed sale did not indicate that Flathead and ENI could not provide safe, reliable electric service at just and reasonable rates. However, its review did confirm that the sale does hold the potential to affect rates and service. MCC stated that the Commission should approve the sale, but recommended that the Commission address rates, the gain on the sale, and transition cost issues.

21. Rates. MCC stated that Flathead’s current rates and rate structure are different from PacifiCorp’s. Flathead recovers more revenue from fixed customer charges than PacifiCorp. MCC’s analysis of rate differences showed that most residential consumption occurs in higher usage blocks where total bills would be roughly equivalent. Flathead eventually intends to eliminate these rate differences but initially will adopt PacifiCorp’s existing rates. MCC stated that the rate moratorium provisions in Senate Bill 390 speak in terms of rates, not revenue, and that the Commission’s order should clarify that Flathead may not increase rates during the rate moratorium period. Flathead has also represented that it will not assess acquired PacifiCorp customers the current membership initiation fee. MCC recommended that the Commission’s order explicitly incorporate this provision as a condition of any approval.

22. Gain on sale. As of the date MCC filed its comments with the Commission, parties to this proceeding had not come to an agreement about how to correctly calculate the net gain over and above the book cost of the assets being sold. Whatever the ultimate net gain turned out to be, on October 28, 1998 MCC recommended that the gain be returned to PacifiCorp’s current ratepayers, allocated to ratepayers to compensate them for having borne the risks and burdens associated with the underlying assets. MCC also recommended that the gain be directly returned to ratepayers on the basis of consumption. MCC stated that a portion of the gain could be used to fund distribution system improvements, but there was insufficient information about the nature and extent of benefits from various levels of distribution investment to justify directing the gain

to this purpose now. On October 30, 1998, in further negotiations on the calculation of the net gain, MCC agreed that \$4 million net gain to PacifiCorp's customers would be acceptable only if PacifiCorp's customers directly received \$2.75 million, with distribution system improvements of \$1.25 million to PacifiCorp's urban areas.

23. Transition costs. MCC recognized that the Commission will make determinations regarding PacifiCorp's transition costs in Docket No. D97.7.91. However, MCC stated that the Commission should assess in this proceeding the effects of a distribution sale approval on the Commission's ability to protect ratepayers' interests in potential stranded benefits.

24. DEPARTMENT OF ENVIRONMENTAL QUALITY. DEQ asserted that there are several issues related to implementing Senate Bill 390 that could affect whether PacifiCorp's sale of its distribution system is in the public interest. The first issue relates to how PacifiCorp's transition plan obligations are transferred to Flathead. The second issue involves whether there is a relationship between the price paid for the distribution system and a power purchase agreement between PacifiCorp and Flathead, and the possible impacts of such a relationship. The third issue is whether the distribution system sale affects the Commission's ability to address transition cost issues.

25. Transition Plan Obligations. DEQ asserted that Senate Bill 390 imposes transition plan obligations on both PacifiCorp and Flathead and that the Commission has jurisdiction to ensure that these obligations are satisfied. DEQ cites § 69-8-103(17), MCA, which provides that "public utility" means any electric utility regulated by the commission pursuant to Title 69, chapter 3, on May 2, 1997, including the public utility's successors or assignees. DEQ stated that PacifiCorp qualifies under this definition, and therefore remains bound by the requirements in Senate Bill 390 after the sale. DEQ asserted that, in effect, the distribution sale is PacifiCorp's latest revised transition plan.

26. DEQ also stated that under this definition Flathead becomes PacifiCorp's successor after the sale and, therefore, Flathead's transition plan for the former PacifiCorp customers falls under the Commission's jurisdiction. DEQ believed that most of PacifiCorp's transition plan requirements would have to be assumed by Flathead. DEQ recommended that the PSC condition approval of PacifiCorp's transition plan, and the concurrent deregulation of PacifiCorp's generation, on approval of Flathead's transition plan.

27. DEQ stated that Flathead's transition plan has not been subject to the public process that is required before a public utility's plan can be approved. According to DEQ there are several components of the Flathead plan that are inconsistent with the requirements in Senate Bill 390. Under Flathead's plan, customers would only be able to change suppliers once per year. DEQ stated that this is not meaningful choice. DEQ also asserted that the Commission has jurisdiction over Flathead's transition plan as it applies to all of the former PacifiCorp customers, not just those in Flathead's affiliate ENI's service area.

28. Link between Distribution Sale Price and Power Purchase Agreement. Flathead's initial offer to PacifiCorp, dated August 21, 1998 included a set of alternative combinations of a premium over book value that Flathead would pay for the distribution assets and a price for a near term power purchase contract between Flathead and PacifiCorp. One of these alternatives is incorporated into the final asset purchase agreement. DEQ stated that the price for the distribution assets may not simply represent the value of the distribution assets, but may contain a component reflecting the value of the power purchase agreement as well. According to DEQ, uncertainty about whether the sale price accurately reflects the value of the distribution assets could create problems if Flathead tries to adjust the basis of the distribution system for ratemaking purposes. While the Commission may be able to forestall problems with respect to ENI, DEQ suggested that the Commission would not have jurisdiction over the ratemaking process applied by Flathead to former PacifiCorp customers in rural areas incorporated directly into Flathead.

29. DEQ maintained that the link between the distribution sale price and the power purchase agreement raises questions about whether the functional separation required by Senate Bill 390 would be achieved. DEQ stated that with the power purchase agreement Flathead becomes, in effect, PacifiCorp's surrogate in marketing generation at retail. According to DEQ, the proposed transaction gives PacifiCorp contractual access to the service area it is selling, contrary to the functional separation requirements in Senate Bill 390. DEQ stated that it is not clear whether the power sale price and the power purchase agreement give Flathead a competitive edge in retail markets, although it appears that the price is better than what Flathead could obtain in the market. DEQ stated that the proposal creates uncertainty about whether Flathead is advantaging itself unfairly. DEQ recommended that the Commission require the distribution asset purchase price to be a "pure price" and that the power purchase price be negotiated separately.

30. Transition Cost Issues. DEQ stated that Senate Bill 390 does not provide that PacifiCorp's transition plan obligations end if it sells its Montana distribution system. DEQ specifically maintained that stranded cost recovery, or return of negative stranded costs, is not affected by the sale. DEQ recommended that the Commission remove any uncertainty about whether PacifiCorp will submit to the Commission's jurisdiction with respect to transition costs after the sale by conditioning its approval of the sale on PacifiCorp's agreement to complete Docket No. D97.7.91.

31. JAMES ROBISCHON. James Robischon, a resident of Kalispell, Montana and a PacifiCorp customer, submitted comments and recommendations to the Commission on the proposed sale. Mr. Robischon recommended that the Commission approve the sale with a condition that the any gain above the book value of the assets must be used to fund capital improvements and replacements to the system facilities included in the sale. Mr. Robischon stated that, in deciding how to allocate any gain on the sale, the Commission must balance the interests of both parties using two well-recognized concepts. First, entitlement to the gain follows the risk of loss; and second, economic benefit follows economic burden.

32. Mr. Robischon maintained that the sale documents demonstrate that PacifiCorp will recover the full amount of the current book value of the assets being sold. Therefore, shareholders face no risk of losing their investment. Mr. Robischon stated that PacifiCorp's ratepayers have, over the years, carried the economic burden of the facilities. Ratepayers have paid taxes and operating expenses associated with the facilities as well as the federal and state taxes on the income derived from the facilities. Ratepayers have also compensated PacifiCorp's shareholders for the dollar value of the depreciation of the investment in the facilities and have provided the shareholders a reasonable return on their investment in the facilities.

Findings of Fact

33. The Commission has evaluated the presentations of Flathead and PacifiCorp and the public comment at the meetings. The Commission and MCC have delved into the financial implications of the proceeding, to the extent possible with this expedited investigation. The comments and recommendations of Mr. Robischon and the MCC generally establish that the sale is in the public interest. The Commission finds that PacifiCorp's proposed sale and transfer of the

distribution facilities and the public utility obligations to Flathead is in the public interest, based on the representations made in this proceeding and the conditions stated in this order.

34. The Commission also finds that it is a fair and just result to apportion the \$4 million net gain to PacifiCorp's ratepayers, as negotiated by the parties in Cause No. DV-98-437B. The Commission renders this finding with some reservation due to limitations of this investigation. However, ratepayers will benefit from the net gain, as negotiated. Further, because this sale is in the public interest and will result in better, more reliable service from a responsible provider, at least at the same rates, the Commission accepts the negotiated Settlement Agreement. Flathead's intention to return local service to the locality was an important consideration.

35. The Commission finds that it is reasonable to grant MCC's recommendation to allocate \$1.25 million to distribution system improvements in PacifiCorp's urban service territory and \$2.75 million to direct payments to PacifiCorp's residential and small commercial customers. In a further proceeding, the Commission will address the appropriate distribution system improvements. For further savings on the transaction, the Commission finds that the parties shall have one year to repay PacifiCorp's customers the \$2.75 million. The parties will work with the Commission concerning the method and timing of repayment, and inform the Commission when PacifiCorp's ratepayers have been full compensated for their share of the net gain.

Conclusions of Law

1. The Montana Public Service Commission regulates the rates and services of public utilities pursuant to Title 69, Chapter 3, MCA.
2. PacifiCorp is a public utility subject to the jurisdiction of the Commission.
3. In exercising its jurisdiction, the Commission must oversee and approve any sale and transfer of utility assets and obligations, in order to assure that the utility's customers will continue to have adequate service and that the utility's rates will not increase as result of the sale/transfer. The Commission must be satisfied that the acquiring entity is fit, willing and able to assume the service responsibilities associated with the ownership of the utility facilities. Flathead is a fit and able electric cooperative in the business of providing electric service. The rates will not increase as a result of this transaction. Flathead will charge all PacifiCorp's customers pursuant to the same tariffs on file, whether ENI or Flathead customers.
4. The sale to Flathead is in the public interest.

5. The sale of the distribution system facilities does not relieve PacifiCorp of participation in Docket No. D97.7.91, governed by Section 69, Chapter 8, MCA. PacifiCorp shall continue participating in that Docket.

Commission Decision and Order

WHEREFORE THE COMMISSION ISSUES THE FOLLOWING ORDER, in approving the sale of PacifiCorp's distribution system facilities to Flathead Electric Cooperative, Inc. and finalizing the negotiated Settlement Agreement in Cause No. DV-98-437B, Eleventh Judicial District Court, Flathead County.

1. Flathead/ENI must adhere to the rate moratorium provisions in § 69-8-211, MCA for all former PacifiCorp customers. In this regard, Senate Bill 390 speaks in terms of unbundled rate components, not in terms of total revenues or average customer bills. Therefore no former PacifiCorp customers should experience a rate increase not explicitly provided for in the Act.

2. Flathead/ENI must file a transition plan to implement the Act's requirements with respect to introducing customer choice and competition for electricity supply in the former PacifiCorp Montana service area. The Commission must have the ability to modify the components of the transition plan, if appropriate, after conducting a public proceeding.

3. Flathead must not assess any customer within the former PacifiCorp service area a transition charge for transition costs, as those terms are defined in § 69-8-103, MCA. Section 69-8-211, MCA provides for the Commission's determination of a utility's transition costs and transition charges. Section 69-8-211(5), MCA provides that approval of transition costs and charges is a settlement of all transition cost claims by a public utility. The Commission is addressing transition cost issues in Docket No. D97.7.91. There is no reason that former PacifiCorp customers should face potential transition charges, other than those that may result in Docket No. D97.7.91, following the sale of PacifiCorp's distribution system to Flathead/ENI.

4. Flathead must honor all contracts of PacifiCorp as agreed and represented.

DONE AND DATED this 30th day of October 1998 by a vote of 5 0 .

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

NANCY MCCAFFREE, Vice Chair

BOB ANDERSON, Commissioner

DANNY OBERG, Commissioner

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.